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Segment: Potential Changes to Your Employer Contribution Rates
Call Operator: Mitch
Host: David Lamoureux, Deputy Chief Actuary

Video Transcript

Mitch:
Welcome to the Potential Changes to Your Employer Contribution Rates conference call. My name is Mitch and I will be your operator for today's call. At this time, all participants are in a listen only mode. Please submit your questions by using the chat feature. Please send your questions to the host and presenter by selecting the Host and Presenter option in the dropdown box within the chat feature. Selected questions will be answered throughout the meeting.

Please note that this conference is being recorded.

I would now like to turn the call over to your host, David Lamoureux. Mr. Lamoureux, you may begin.

Host:
Thanks, Mitch. Good morning everyone. And, I'm David Lamoureux, I'm the Deputy Chief Actuary at CalPERS. As Mitch mentioned, I just want to make sure, if you have any questions as we go through the presentation, feel free to send them right away. We're going to be taking questions as we go through the material. I've got another actuary, David Clement, sitting here with me that's going to help me. He's going to be the one interrupting me and asking questions as they come through, through the presentation. So, let's begin.

What we want to talk about today is basically we want to try to cover what we see happening to employer contribution rates over the next three fiscal years. So we're talking about 11/12, 12/13 and 13/14. And, so, at which these kind of topics are. So we're going to be talking about the new actual assumptions that were adopted by our board earlier this year that they're going to impact the 11/12 rates. We're also going to give an update on the three year fazing that our board adopted in 2009 that's going to impact our rates for the next three years. And we also want to cover a topic that some of you might have heard already about there might be, there's a possibility that we might be changing the discount rate at CalPERS that could result in changes here in employer rates. And we're going to be talking about that.

And at the end I'll be spending a little bit of time about, on topics on, you know, since we're going to be talking about potentially higher rates increasing over the next few years, we want to present to you options that are available to employers, if you need help to cope with the employer rates. So.

The new actual assumptions, back in April of this year CalPERS staff completed an experience study of a ten year period ending on June 30, 2007. What we, uh, that study was basically, an experience study is basically a comparison of actual to expected experience. What we basically did is we took a ten year period and we look at things, for example, you know, how many people retired versus how many we expected, how long did people live, how many people leave employment every year and so forth. So we did that study to basically set actual assumptions. We went in front of our board in April of this year and the board approved these new actuarial demographic assumptions. And we used those assumptions for the first time in the June 30, 2009 valuations. Now, hopefully, at this time for public agency employers that are listening, we mailed all of our report. I think the last report went in the mail last Tuesday. So, hopefully, everyone as of today have their reports in their hands. If you don't, they should be coming shortly in the mail. So, so, basically, the report you received is the June 30, 2009 report, and that reflects those new assumptions that were adopted by our board.

So, what these new assumptions are used for, they're basically used, we use them in the actual office to project your benefit payments and to set your employer rates. But, what I also want you to be aware is, we're also going to be using these new assumptions anytime we do an amendment valuation. So, if you're contact, if you plan to contact us shortly to obtain information about the cost of changing benefits, whether it's to provide higher benefits, or whether you're considering a lower tier of benefits, these new assumptions will also be used for this.

And, there also, I'm going to talk about this in more details, but they're also going to be used for all member calculations at CalPERS and those come in the form of two things: One that we call the optional forms of benefits, like what people going to select at retirement; and, also, if you have members that want to purchase service; these new assumptions area also used for this, so I'll talk about this in a little bit more detail shortly.

So, the assumptions that we studied in our study were basically mostly demographic assumptions. When people retire, how long do they live, when do they terminate employment. And we also looked a little bit at salary increases, but, mostly what we, like what we call seniority merit and promotions. So, basically, salary increases that an individual employee might receive as they move up in their ranks.

One thing that's important to note also for public agency employers, this is the first study where we were able to collect data for the three new formulas referred sometimes as the AB 616 formula: the 2.5 at 55, the 2.7 at 55, and the three at 60. When these new assumptions were, when these new formulas were introduced back in 2004, we had no experience available, so we had to make an estimate as to how we thought people would behave under those formulas. We were about to collect about five years of data, and so we basically made an adjustment to the assumptions we used for those three formulas. So, for those that have those formulas, if you've already received your report and you have on of those three formulas, you're going to notice that the impact of the new assumptions was a little bit higher for this.

Now the main result of the study is, basically it can be broken down to three categories. The first is, the good news as an individual is everybody is living longer, especially for males. What we also noticed as part of our study is we're noticing that everyone is retiring at slightly younger ages than they used to. And, also, with respect to our salary increase assumption, which we notice is people with longer service like 25 years or more, we're still getting more promotions than we had initially anticipated. So we made a slight adjustment to our salary increase assumption.

And with respect to life expectancy, I just want to show you this. This is just to show you how the life expectancy changed for males versus females. It's actually; it's interesting to see that for males the life, how long, basically how long a male individual is expected to live, the life expectancy has increased by almost a full year just over a five year period compared to about two to three months for females.

Now, I just want to, before I go to the next slide I just want to ask the audience, you're going to see a poling question right now. I just would like you, if I asked you a question, do safety, do you think safety workers live longer than miscellaneous members? So, if you think safety workers live longer, please say yes. If you think miscellaneous workers live longer, please click on the no button. Just wait a few seconds. I've got. Just so everyone knows while I'm waiting for the results to come in, we've got about 320, over 300 participants today. So I'm just waiting to see how many are coming in. Perfect. Very good. So I can see. Right now what I see on the screen is about almost 60 to 70% of you think that safety workers do not live longer than miscellaneous. Now, the real answer is, no. We actually looked at the experience for the last, over the ten year period that we looked at. And, what we found is safety workers do, in fact, live slightly longer on average than miscellaneous workers. We've also looked to see if it was different for firefighters, police officers, county peace officers, and what we found is, even if you look at all these categories separately, on every one of those categories the members live slightly longer than the miscellaneous.

If you're, I know sometimes, we've heard in the past that, I think it was based on a study that probably was published in the late seventies, early eighties that said that most safety workers live three to four years after retirement. It is not the fact, at least at CalPERS, on the data we see. If you are interested in finding out more details than what we've done, we did as part of our experience study we published a report. It's about, I think, 60 to 70 pages long. It is available on our CalPERS website. The link is provided here on this slide. And the information about miscellaneous versus safety can be found on Pages 34 and 35 of that report.

David Clement:
And they've got a few questions here.

Host:
Yes.

David Clement:
Will these slides be available after the presentation?

Host:
Yes, they will. Basically, we're still working on the details, but what we're planning to do is, all the participants to today's webinar, you have to provide an e-mail. We will provide, we will put a copy of the slides on the CalPERS website and the audio will also be available, as well. And any questions we receive today, we will answer them in writing as well, and we'll be putting them on our website. So, what we intend to do is once all of this is available, we will contact all participants and you will be provided with a link to the CalPERS website where you can download everything.

David Clement:
Now you mentioned the valuation reports in the mail last week. Is there any chance we can get those on the internet?

Host:
Not right now. Basically, you've heard of CalPERS going through a big IT project referred as My CalPERS. I think beginning, it's supposed to roll out about a year from now in September 2011. Once this new IT system is in place, we will now provide everything to employer in an electronic fashion. So, basically, instead of receiving your reports in the mail, those will be sent to you electronically in a PDF format. And, going forward, we also intend to put all of those on the internet. So, right now the answer is no with respect to reports, but it's something that will begin within a year or two. Everything will be communicated to you through the internet and through e-mails.

David Clement:
Cool.

Host:
Okay. Let's continue. Okay. Now here's probably what all of you are really interested about is, could these new assumptions, what is it doing to me, to my budget, to my employer rate? Now, what we've listed here are ranges of what we saw when we did our valuations, how employers were impacted.

For those of you who have received your report, you should be able to see exactly in your report how your employer was impacted. We have a page in the report that lists the reasons why your employer rate changed. And you should see one that says, "Impact of New Actual Assumptions." But just to give you an idea, most, for miscellaneous plan were broken down into two categories because of those that had the AB 616 formulas, the 2.5 at 55, the 2.7 at 55, and three at 60, those were impacted a little bit more. So, as you can see, one to two and half percent of payrolls. For the other miscellaneous, the two at 60 and two at 55, what we saw were mostly increases of less than one percent of pay.

For safety plans, the increases were more, more in the range of two to three percent. And the main reason here why safety plans were impacted more, I want you to think back to about two slides ago when we talked about life expectancy and we said that the male life expectancy went up by almost a year, while for females it was only about two to three months higher. Most safety plans tend to be like 80 to 90 percent male. So, therefore, any plan that has a high proportion of male member is impacted much more by the change in assumption than others. So that's the reason why you see the bigger change for the safety plans.

Okay. And, again, as I said, so the change, so basically the biggest impact on all the changes for the new assumption was the change in post-retirement mortality, the life expectancy. And for safety plan, just for that alone it was almost one to two percent of pay.

Now the, the one thing I'm going to say, the reason. You know, you have to keep in mind, you're probably saying like why are you changing the assumptions right now, everyone is having budget issues. You know, we understand this. We understand that changing the assumptions is causing employer rates to go up. But, one of the things you have to keep in mind is we're trying to ensure that the benefits you promise to the employees are properly funded, and we, you know, we believe that it was important to change these assumptions to ensure that over time your plans and the benefits you provide to your employees are properly funded. It was basically, that was the main goal of changing the assumptions, is to ensure that all the benefits you provide are properly funded.

Now the last part I'm going to talk about, about the new assumptions is how it impacts member calculations as I mentioned in the beginning. So, the first one is the optional form of benefits. For those of you that are not sure what I'm talking about is as a member, when you retire you have the right to select what's called an alternate form of payment at retirement. So, in fact, if when you retire, you know, you will be given the option as a member if you wanted to leave let's say a 100% of your benefits to your beneficiary after you die, you have that option. But the member must pay for that cost. It's like buying life insurance at retirement.

One thing that you have to keep in mind is, it's interesting, this is probably the only place at CalPERS where when we changed our assumption that it resulted in a benefit for someone. Because members are now living longer it actually will be, it's now cheaper for members to choose an optional form of benefit because it's like buying a life insurance. So, if you're going to live longer, it's, it becomes cheaper to buy life insurance products. So that's the one place that CalPERS where members are seeing a benefit from the change in assumption that the CalPERS board adopted.

The other type of member calculation that's being affect is the, for members purchasing service, especially what's called the additional service retirement credit, the ARSC, are also known as air time.

Most of you are aware active members have the right to purchase up to five years of service at anytime prior to retirement and, the cost for that service is based on the assumptions of future salary increases, when are people going to retire, and how long members are going to live. Because we changed those assumptions, it also resulted in increases in cost for people buying service. As part of the experience study we also found that people that bought ARSC service were retiring much earlier than other individuals. So we've asked our board to also make, to adopt a different assumption for, just for purposes of calculating service credit, purchase costs.

And, we went in front of our board in September of this year and our board adopted these new assumptions for all service credit purchase under what's called a present value method. And what happened as a result of this is that the cost went up significantly. This is a slide showing you just an average, just the average increase we saw by categories. If you're a local employer, now your members on average for miscellaneous are being charged, are being asked to pay about 17% more than they used to, to buy service and, for public agency safety, about 24% more. Now the main reason we did this, as an employer you have to understand that if we had not made that change for service credit purchase, then going forward anytime an employee had bought service, the employer would have been responsible to pay the difference. So this was a necessary change for us to ensure that the, the law says that this cost is supposed to be, it's supposed to be cost neutral to the employer. So this was a necessary change to ensure that employers didn't have to pick up part of the, no, didn't have to, what it impacted by service credit purchase.

Now, some of you might be aware, but our board when they adopted these new assumptions, everything became effective immediately on September 16. So, what CalPERS and what the CalPERS board adopted is for service credit purchase it works based on the date the application was received by CalPERS. So, any service credit purchase application that was received by CalPERS on September 15th or earlier was still done under the old assumption. Any application received on September 16th or later, they got the new assumptions. And for retirement it's actually the retirement date is the driver. So, for someone retiring on September 15th, if they wanted an optional form of retirement, it was based on the old assumption. If they retired on September 16th or later, they got the new assumption. So that's how our CalPERS board implemented everything.

David Clement:
Hey, Dave, the ARSC?

Host:
Yes.

David Clement:
How come it went up so high for schools? Thirty-eight percent for schools?

Host:
Yeah. Basically, we, one of the thing we, we found, too, we, you know, we looked at the experience. A lot of it was experience driven. We looked, if you, back in 2004 when ARSC came on board we had to make an assumption at the time as to, you know, when someone buys service because they do it while being actively employed, you need to make an assumption as to how long you think people, you know, when you think they will retire and start drawing that higher benefit, and how long are they going to live. And we had to make some assumptions at the time, and what we notice is that in the case of school employees, especially because of all of them are part-time employees, we felt that they might be retiring at much later ages than state miscellaneous, for example, which has the exact same benefits. But, after collecting data for six years we noticed that, in fact, school employees were not that much different from state miscellaneous. They behave quite similarly. So we just, uh. So, if you look now at the cost, if you had looked two years ago, it was much cheaper for school employees to buy service than from state miscellaneous. Even though they had the same benefit structure, now they're pretty much both in line because we noticed that members behaved in similar fashion. It more has to do with the, how we thought school members behaved before we find out that we were not basically, what we thought would happen did not happen in reality so we brought them in line with reality basically. So we realized that it was much higher for school members. Anymore questions?

David Clement:
Uh yeah.

Host:
Basically, yeah. I'm just going to …

David Clement:
Have we, have we put these, built these new assumptions into the online calculators?

Host:

Yeah. Basically, all these, all these assumptions have been, for those of you that if you tried to look when our, when our board adopted an immediate implementation of September 16th, we were not quite ready for this. So I think for about a month or month and a half all the online calculators were shut down. And I think some of them were brought back live in the early October. So now all of them, if you have use the online calculators since October, the new assumptions have been on the online calculator since then. So.

David Clement:
Do you know about how many applications have come in after the increases?

Host:
The applications have really come down afterwards. We're still getting a couple hundred applications every month. But we, you know, it's two things. I think we got, I know we had a, as you would expect, we had a little surge of application that they, that on September 15th, the day our board made the decision. But, since then the, some of the app … the applications have come down, but not that much. What we're noticing is the number of people buying service is down significantly. It's the, uh, yeah.

David Clement:
I have a couple of questions here.

Host:
Yeah.

David Clement:
So, does this mean that if you bought your air time prior to the increase, does that mean the employers will be picking up the cost of the difference?

Host:
That's correct. You know one thing you have to keep in mind, even under the new cost, okay, if you look at an individual person, if you look at one person, if you have only one employee that buys service, as an employer you're either going to make money out of it or you're going to lose money out of it. Cause there's a lot of assumptions that come into play. And one of the key is also how long is that person going to live? You know? If you, you start from those life expectancy table, we assume most people will live until about 80 to 85. If one of your employee that buys service lives until about age 90, then it's certainly going to cost you a bit more than what we anticipated. If they live only up to age 75, then you're probably going to, you know, as for, from the point of view of your pension plan, you're probably going to have a gain because they didn't draw any many, as much benefit as possible, as we were expecting. So the, the key here is we believe that these new assumptions are going to help reduce the likelihood that the employer is going to be affected by the service credit purchase. But in reality you don't really know if you're affected by it or not until the person that

bought service retires and you have to wait until how long did they live. So it could take 30 to 40 years before you find out, if for a single individual, if you were right and if you, you know, if you lost some, you know, if you were, if you had a gain or loss, if you want. So, it's not as clear cut as it seems. But it's, if they bought service before the change in assumption, we believe it is, it was a bit more likely that it could result in a loss to the employer.

David Clement:
One last question on the air time. Why did PERS make the airtime increases effective immediately?

Host:
This was as a result of a, some additional information came available in July as a result of a court case in San Diego where a retirement system had implemented their, gave members like a three or four month window period to make the decision whether they should buy under the old assumption and the new one. And the court ruled that it was basically that you should not be doing this because you're passing costs to employers. So what they're saying is that, what the judge ruled is that if you know that the costs should be increased, it should be increased immediately. So, in light of that ruling the CalPERS board decided to go ahead with the immediate implementation. Which was different from what had been done I think six years ago where the CalPERS board had given like a three months window period.

David Clement:
That's just very time.

Host:
Perfect.

David Clement:
I think we can move on.

Host:
Perfect. So we'll go. So the next topic we want to talk about is the, what we call at CalPERS a three year phase in. This is basically, it's what we, it's part of what we call the CalPERS rate smoothing processes we have in place. Most of you are aware for years we've been employing, CalPERS has been employing a rate smoothing approach to dampen the impact of the investment market volatility. What we've been using for years is we have a method where we basically spread gains and losses over a 30 year period and then we amortize those over 30. Now just to help you better understand what that really means is, let's say we lose $15 Million in one year. So the 15 years spreading means that we're going to take that 15 million and we're going to spread it over 15 years. So, year one we recognize one million. Then that one million we don't charge the employer for it right away, we amortize that over a 30 year period. And the 30 year period

comes out to be about 6%. So, 6% of one million is about $60,000. So you can see that if we lose $15 Million, in year one we ask the employer only to pay $60,000 toward it. So you can see how it's really smoothed over time. And the idea behind this is that hopefully it's, you know, it's, we know that gains and losses are meant to cancel one another over time. So the idea behind it is in year two if we had a gain of $15 Million, then the whole thing gets wiped out and we really never had to increase rate that much for employers. So that's the whole idea behind smoothing.

Now what really happened is, if you recall, this works great when you have like, you know, small gains and small losses from year to year. But what we really saw in 2008 and 2009, if you recall, CalPERS lost 24%. Our return was negative 24%. That was 32% below what we assume as actuaries. We, our long term expected return is seven and three quarters, about, almost 8%. And we had a negative 24. So that's a 32% difference. And what we found out is the methods we were using to smooth the rates were not, would not have been able to cope with such a big decline and it would have caused dramatic increases to employer rates in 11/12. So, what our board did is in June 2009 they adopted a temporary change to our method that's basically phasing the impact over a three year period. So the first year of the phase-in is beginning in 11/12. So. And, so. And then it's going to, then there will be another impact hitting you in 12/13 and another one in 13/14. I will show you a bit more of the details going forward.

So, what I've got on the next slide is basically a table that is going to show you how we think that phase-in is going to impact you over the next three years. The main things I want you to be aware, so it's based on the negative 24% return that we had for 08/09. In 09/10 we had a return of about 13.3% at CalPERS. Some of you might have seen a press release that went out in like the middle of July that said we had about 11% return for 09/10. The main thing to keep in mind is, because CalPERS invests heavily in real estate and private equities, those asset classes because they're not traded on a day to day basis, they don't really have a, it's hard to get a fair market value, you need to have an appraisal done. And, usually those come in early October every year. So when the appraisal came in for real estate and private equity, it came in a little better than what the investment staff had originally anticipated. And as a result, the return was 13% instead of 11. So that was good news. And for the other years we've assumed seven and three quarters. So, this is what you're looking at for the next few years. For 11/12, this you should already see it in your valuation reports. So, after this webinar, if you go back to your valuation report, remember I talked about it before, that there is a page in the valuation report. Unfortunately, I can't remember off my head right now which page it is. But there's a page where we show a reconciliation of the rate, like why it changed from 10/11 to 11/12. So you're going to see a row that shows, you know, change in new assumption and you'll see another one that will show also the impact on the investment return.

And, for most miscellaneous plan you're looking at about a half a percent of 0.4 to 0.6 percent of payroll. And for safety plan about one percent of payroll. That's for 11/12. But you already have that in your hands.

Now, if you recall, and for local agencies in the report we just mailed you we also provide you an estimate of what we think the 12/13 rate is going to be. And the impact of this was built into it. But, so basically the impact of that three year phase-in we anticipate for that miscellaneous plans it's going to be about another half percent of pay in 12/13 and for safety plan a little bit less than one percent of payroll. And the main reason why it's even lower than 11/12, it's the fact that we had a good return for 09/10, that 13%. Okay.

Now, if you look at 13/14 here, this was done based on our assumed seven and three quarter percent investment return assumption. Now, what you're actually going to see for 13/14 it's going to be, it's going to heavily depend on what CalPERS is actually going to earn it's investment in 10/11. Now, so far this year, I'm going to knock on wood here, and hopefully everyone can hear this, is we're up about 10/11 percent fiscal year to date. So that's good news. So, to the extent that we earn more than seven and three quarter, the rates that you see here are going to be slightly lower. To the extent we were to earn less than seven and three quarter, then what you see here would be higher. But, basically, for most miscellaneous plan you're looking at something between like around one and a half, two percent of pay higher in 13/14 and, for safety plan like between three and four percent. Now, note that these, you have to add these on top of one another. So, if you're currently paying 10% in 10/11 in your safety plan, the impact of the three year phase-in is probably going to add one percent in 11/12, another one percent in 12/13, so you're up to two percent. And, potentially another three to four percent for 13/14. So you're up like five to seven percent. And the reason I've got 14/15 here is even though the three year phase-in is done, you remember we had a 15 year smoothing built into all of this. That means that unless we have a set in gains going forward, there will continue to be small losses that will be recognized every year for like the next 15 years. So, unless we have, we continue to have good returns, the rates will continue to slowly creep up over time. I just want everybody to be aware of this.

David Clement:
Hey, Dave?

Host:
Yes.

David Clement:
Those projections, three year projections?

Host:
Yes.

David Clement:
Would the schools pool fit into that typical miscellaneous plan?

Host:
Basically, for the schools pool, if we have school employers listening right now, we did send a circular letter out that, if you haven't received it, it's on our website, we did do that same three year projection you see there. Yes. To first answer your question. Yeah, school employers will look like the typical miscellaneous plan, probably closer to the bottom end of that range. But, if you want to know more exactly how it's going to look, we did send a circular letter just a few weeks ago that went out to all school employers providing information on basically what we were estimating the 11/12 and 12/13 and 13/14 rates to be. So this should already have been sent to you. But, basically, if you are school employers, just use the bottom numbers of the miscellaneous, of the range for miscellaneous plan here. That will be close to what the school employers will see.

David Clement:
Just to let the audience know, we're getting a lot of questions about the interest rate return. We're not ignoring you. We're, it's coming up in the next few slides. So I just wanted you to be aware of that.

Host:
Yeah, we're about four slides away from what I think most of you want to hear.

The one, what I want to talk about here is, for those of you that have received your report, for the first time this year we've included an investment return sensitivity analysis. So, if you recall in the past for local agencies, we always provided you, when we mail your report we provided you with the rate, for example, this year we're providing you with the 11/12 fiscal year rate. We're providing you with an estimate for 12/13. And, this time around, for the first time, we're also providing you an estimate for 13/14.

The only thing is that 13/14 rate is dependent on the investment return we're going to earn in 10/11. And, because that number is still not known, what we included in your report are five scenarios. Okay, what if we earn seven and three quarter? What if we earn much better and earn 16? What if we did worse and earn zero? And what if we had either a very, very bad year at negative 11, and what if we had a super good year at 27%?

And, so, what I've put here on the next two slides, we've got a miscellaneous and a safety. It's just for typical miscellaneous plan how it looks. But, the main thing I want you to be aware here is, you can see that these are all positive numbers. Even if we were to have a 27% return in 10/11, it's still not going to prevent employer rates from continuing to increase. And the main thing here, I just want to go back to what I've told you before. We expect to earn about eight every year. We lost 20, we had a negative 24% return in 08/09. That was 32%, if you want, different from what we expect. In 09/10 we earned 13. That's about five percent more than what we expect. So you can see we still have about 27% of losses that still need to be made up. Even if we were to have a 217% return, that's only 19% more than what we expect. So, you can see that there's still, we would need to have tremendous returns for the next few years to prevent employer rates to continue to increase. I just want you to be aware. So, here I've got a just for typical miscellaneous plan and a typical safety. And, again, in your report you're going to see, you're going to be able to find a table that looks exactly like this that is specific to your plan.

And, again, if you have any questions on these, as usual, we just ask you, you know, pick up the phone, call your assigned actuary. You now, they'll be happy to go through all of these numbers with you.

Okay. The discount rate assumption. What's been the hot topic. So, basically, it's just to give you some background. Every two to three years the CalPERS board performs what's called an Asset Liability Modeling Workshop. It's open to the public. A workshop was held last month in Sacramento on November 8 and 9. And what they did during that workshop, basically, what they were presented during that workshop, the board members were presented with options. You know, do you want to, you know, going forward, do you want to take less risk with the investment? Do you want to keep your level risk about the same? Do you want to take more risk? And what the board members expressed was a desire to keep a similar level of risk.

Now the final decision on the new asset allocation is going to take place next week on December 15. So, on Monday, on December 13 the investment committee meeting, the investment committee will meet in the morning. They'll be, this is when they will make a preliminary decision as to what asset allocation do they want to select. Right now I believe the agenda items are probably on the website. If not, they're probably going to be up tomorrow. But the board will be presented with four alternatives, all with very similar level of risks. And they will, that committee will make a recommendation to the board on Wednesday to select one of those four asset mixes.

And the key here is that we won't know exactly what to do with the discount rate assumption until we know how they want to invest. So, right now what we're looking at is, our current assumption is seven and three quarter, like I mentioned before. And, based on what they select, it's quite possible that we might have to recommend lowering the discount rate to 7.5%. So, first we have to wait until the board takes action next week. Once they do this, the next board meeting is in February, so we will go back to the board in February to make a recommendation. But we have to wait, at this point. If you ask me right now, is it going to be seven and three quarters, seven and a half? I know if some of you were in attendance at the employer forum, or, if some of you heard what was discussed at the employer forum, our chief actuary Alan Milligan did bring up, at the time, that we could lower it to seven and a quarter, seven and a half. We don't think seven and a quarter will be an option mostly because we didn't know at the time what kind of risk the CalPERS board wanted to take. If they had told us they wanted to have a much lower level of risk, then seven and a quarter would be in the picture.

Now, I think what we're looking at is either keeping it at seven and three quarter, or lowering it at seven and a half. And, if we do lower it to seven and a half, I've got two tables. The first one here you can see is a, this is for the state plans, and for schools I know we have a few states, we have a few representatives from the state listening today. So this is what we expect the impact to be for the state plans if the board goes to seven and a half. And you can see for the schools pool is about 2% of pay.

For local agencies, what you're looking at is one and a half to three percent of pay of your miscellaneous plan, and three to five if you're a safety plan. So, you can see just a quarter of a percent change and the discount rate could have huge impact to plans. So, what we intend to do, you know, we understand that right now we're, you know, we just want you to be aware that this might be coming. The moment we know for sure what's going to happen, so we don't know for sure until February, our plan is to basically, the moment the board takes action, we're going to be sending out a circular letter. We might even do, we're thinking about maybe even doing a little webinar again, just a short one, to kind of tell people exactly what's happening and when you're going to see increases. But the thing to keep in mind is, if the board does make a change to the discount rate assumption, what you're looking at is for state plans and the schools pool, that would kick in right away in the 11/12 fiscal year. For the state and the schools it doesn't give you much time to prepare, because you probably will know in February and it's going to kick in on July 1st. For public agencies you're going to have a bit more time. You'll have about a year and a half to prepare. It will kick in, in 12/13.

So, you know, I've been talking about a lot of increases and new assumptions, the phase-in, the possible changes to the discount rate. What we've tried here is to summarize it in a table to kind of show you how everything works together. So, let's say you're miscellaneous plan and you're currently paying 10% of pay. In 11/12, which you've already received your reports, you should see this. But your rates just for 11/12 should have gone up by about one and a half to three and a half percent just because of the new assumption in the Part One of the three year phase-in.

Now, in 12/13, if we do change the discount rates, remember it's only if we change the discount rate and lower it to 7.5, if you combine this with the impact of the three year phase-in that I showed you, that could result in another two to two and a half percent increase in rate. So, if you're a miscellaneous plan and you're currently paying 10, I'm just going to pick kind of the middle of the range, it's possible that, you know, in the 11/12 year rate is now 12. It could go up to 15% in 12/13. And, now in 13/14, if you recall, and that's the Part III of the three year phase-in, it might be going up by another 2%. So if you add 10 to 12 to 15 to 17, so it's possible that your rate for miscellaneous, if you're currently paying 10, it could be 17% in 13/14. So, and, you know, you could do the same calculation for safety plans. So, as you can see, it's not pretty. The rates are going up. There's really, because of the big loss we had in 08/09, there's really not much we can do about it. So. Now the impact in the changes in discount rate, again, this is right now it's just a possibility, it's not for sure, we'll have a better idea next week after our board decides on which asset allocation, then we'll make the final recommendation to our board in February. But we have to wait until next week before we know better.

David Clement:
Perfect.

Host:
Do we have any questions on this that?

David Clement:
Yeah. Can you explain the process of changing the discount rate in February?

Host:
Yeah. Basically, you know, anytime you want to, you see, the discount rate assumption is linked, basically it's a representation of what we expect to earn going forward on our assets. And the reason that we still don't know exactly what we're going to recommend is we need to know exactly, you know, how much does the CalPERS board want to invest in equities, how much do they want to invest in bonds, in real estate and so forth. Each of these asset classes has a different expectation for future returns. So, that's basically the whole process. So, first we wait for the asset allocation of the board, the asset mix that the board wants. Once we know what the asset mix is, then we will be able to know better how much we think we can earn going forward, then we'll bring that to the board in February. So, in February what the board will be presented with is, you know, based on the asset mix that you selected we think we can, you know, we believe we CalPERS can earn X percent on each of these asset classes, if you kind of add them together, it will either translate into a seven and three quarter, or seven and a half expected return. So that's kind of the process behind it. But the key here is it's driven of the asset mix. So we have to wait first on how the board wants to invest the assets. Then we can make a decision. That's the reason why it's February and not sooner, because we have to wait until the board takes action in December.

David Clement:
When you say we, you're talking about the actuarial office, maybe the chief actuary makes a recommendation?

Host:
No.

David Clement:
To the board?

Host:
Yeah, it's the, it's going to be a recommendation made by the chief actuary. But it will be, I think we're working, we're an investment staff. It will be a common agreement between the actuary office and investment professionals as to what, you know, we believe CalPERS can earn in the future with respect to earnings. So it will be, our chief actuary will make the recommendation. It will be a, you know, it will be a common agreement.

David Clement:
Ultimately it's the board's decision, right?

Host:
Yeah, ultimately it's the board's decision. That's correct.

Just so that everyone knows, CalSTRS did make a, adopted a, lowered the discount rate assumption last week in their meeting. They were at eight, so higher than CalPERS, and they lowered it to seven and three quarters. So, now, so, now our board is looking at whether or not we should lower it from seven and three quarters to seven and a half. And, again, you know, sometimes also keep in mind when you compare one system to another, if you compare CalPERS to 37 Act County, why are they using higher, why are we lower? One of the key drivers is the asset allocation. And, if you compare all of these systems, all of these plans, no one is invested the same way. So it's, sometimes it's normal to have a different answer, a different discount rate for each system because you are all invested in different fashion. So I just want everybody to be aware of this.

David Clement:
CalPERS is changing, well, the assumptions and then the interest rate, will CalPERS be looking at that, be revisiting that in three years?

Host:
Basically, there are two things to this. The demographic assumptions, the study we did, by law we're required to do such study every four years. It does not mean, well, so the next time we'll do it will be four years from now. We'll be looking again how long do people live, when do they retire. It does not mean we'll be changing assumptions. We just kind of look at our current assumptions, was this reality, if it sees that reality is in line, then we might not change. But the earliest you're looking at for this is the next expense study four years from now. With respect to the discount rate, that's linked to how the assets are invested at

CalPERS. And our CalPERS board kind of looks at the asset allocation every kind of three years. The last time they did was 2007. So, you can kind of see that probably after these changes it's probably not going to happen for another three years, probably, is what the schedule looks like right now.

David Clement:
I think we can move on now.

Host:
Okay. So that basically covers what we wanted to talk about for where the rates are heading.

Now the first thing I wanted to talk about is, some of you are aware that if an employer wanted to, there's something at CalPERS that's called a funding extension. You know? For employers that are having issues of, you know, financial issues, you can ask CalPERS for what we call a financial hardship request where we could, what we would do is we would amortize any unfunded liability you have over a 30 year period. And the 30 year period is the maximum allowed by GASB. So that's basically where the 30 year is.

A few things I want you to be, that you need to be aware. If this is something you want to consider, you will be required to ask, to send CalPERS in writing, you'll have to submit what's called a statement of hardship. Basically say that, you know, I'm having budget issues and I would like to have a funding extension to help me. You must notify your employees that you're asking CalPERS for such request. So, in your letter you have to say that, yes, I did notify my employees, they're aware of it. You also have to keep in mind that the, it's not granted, you know, it's not a 100% sure that you will be given the funding extension. CalPERS actuaries will be looking at different things with respect to a plan. We're going to be looking at your future cash load. We're going to be looking at your current funded status. We're also going to be looking at what we call, you know, what is your, what the funded status would be if you were to terminate your plan. And the last, one of the other thing, too, we're going to be asking is, I've shown you that the rates might be increasing quite a bit for the next two/three years. If you're calling us this year and say, you know what, I need help for 11/12, it's quite likely that the first thing our actuaries, you know, CalPERS will ask you is, okay, you need help for 11/12, but how do you intend to cope with the increase that's coming in 12/13 and 13/14? So, that's another thing we're going to be asking you. Because, you know, if you need relief for 11/12, you know, if you're rates are going to up another two to three percent in 12/13, how are you going to be able to cope with this? So we're going to be asking you all of these questions.

Now, we went in front of our board in September, if I recall. Yeah, in September. And we had them approve kind of formal guidelines with respect to funding extension. And what's important to note for you is first, current law. The law can always be changed. But the way the law is written right now, Government Code 20812, says that a funding extension can only be granted once. So what we're, the reason we're saying this right now is if you think you might want to ask for a funding extension for 11/12, think about 12/13 and 13/14. If you think it might be more useful in those two years, because you would only be able to ask for it once. The other thing, too, that our board adopted, as part of our guidelines, our board adopted, such request must be received by CalPERS by May 31st. So, if you want relief for 11/12 fiscal year, we have to receive it in this fiscal year by May 31st. And, basically, CalPERS will give you the, will say yes or no by July 1st. So that covers funding extension.

The next part I want to talk about is employee cost sharing. I know we've had many employers calling us to say, you know, how can I ask some of my employees to share the cost of a, you know, the increasing pension costs? Now this can be done two ways. If you do it through CalPERS, you can do it by contract amendment. However, you have to be aware that there are some limitations. You can only do this to share the cost of a benefit improvement. That's because of how the law is written. Then, so, basically, if you, even if you did a benefit improvement six years ago, you can base it on this. So that's the main thing I want you to be aware. And, again, it's required with an agree, you'll need to have a written agreement with your employee groups, and CalPERS is probably going to ask for a copy of the MOU or something. And, so. And, if you agree, let's say you agree that the employees should pay, you agree with your employees that they're going to pay 3% more, then it's just going to result in 3% less for the employer. So that's the way to look at it.

So, the key here is the maximum you can share is what's related to past benefit improvements. If you've never done any benefit improvement through CalPERS, then unfortunately right now because of the way the law is written, you're out of luck. There's no way you can do cost sharing through CalPERS. But, if you did a benefit improvement, even if it was ten years ago, the way we're going to do it is we're going to, the maximum you can share is the increase in normal costs that resulted as a result of benefit improvement and a 20 year amortization of the increase in unfunded liability. So, if you did that ten years ago, what we're going to allow you to do is to share that 20 year amortization only for the next ten years. So that's basically how it works.

If you're interested in getting more details or find, again, I would just suggest that you contact CalPERS. You know, your contracts were presented, therefore, they actually can help you walk through this. But that's basically what's offered through CalPERS. You know, the advantage of doing it through CalPERS is at least those increased member contributions will go into the members account. So, if they were to take a refund, then they'll be entitled to it. Because the other option you've got is to do it by MOU. You know, you could agree to anything by MOU with your employees. But, two things to keep in mind is, these contributions you would not be able to be reported to Cal … they would, you would probably give them to CalPERS, but they wouldn't be treated like regular employer contributions. That wouldn't be credited to the individual members account. And the other thing to keep in mind, too, is that it's probably not going to be tax deductible for your employees because it's not going to show like a, it's not going to be counted like a contribution toward their retirement plan. So just keep those things in mind. Again, the law can always be changed. But that's the way that the law is written right now.

David Clement:
Hey, Dave?

Host:
Yes.

David Clement:
We have a question here. Employer rates are increasing pretty, with some large increases and is CalPERS looking at sponsoring maybe less legislation that would allow the employees to cost share without tying into a benefit improvement? Does?

Host:
Yeah. I think right now, just so, I don't think CalPERS is planning to sponsor anything right now. But there is a, there's a, CalPERS is, there's a group that was created that's called the Pension Workness, no, Pension Soundness Workgroup. That basically CalPERS is working with employer representatives, labor representatives, with a representative from the legislatures, and from the legislature, and they're looking at all of these ideas, and I think they are trying to come up with some proposal, and I think the idea is to come up with ideas and potentially propose new legislation in the upcoming sessions. And I know that this is one of the topics that they're talking about as to potentially de-link cost sharing with benefit improvements so that you could just tell CalPERS, you know, we've got an MOU, we've agreed to pay 3% more and you can do it through CalPERS. But there's a group working on this, so it's, I believe from what I've been told, there's a potential that this could be a proposal. So, so we'll keep everyone informed.

The last thing I just want to cover real quick is a lower level of benefits for new hire, what's called a second tiers. We're seeing a lot of this activity right now at CalPERS. Just so that everyone is aware, vested rights, like especially in California, has prevented employers from reducing retirement benefits for current employees.

So, I think right now what's available through CalPERS, is you can offer lower levels of benefits, but for new hires only. And, if you are considering this, cause we did get, I think just since the beginning of the fiscal year, we've received like between two to 300 requests at CalPERS to provide cost information on lower levels of benefits.

A few things that you need to be aware as an employer, if you're considering this, saving will be very, very small in the short term, especially if you're not hiring anyone right now because, you know, you're having budget issues. It will take years for any savings to appear, probably at least a good 10 to 15 years. And, if you have an unfunded liability, which most plans do right now, this is not going to result in any reduction in your existing unfunded liability. So I just want you to just be aware that this is probably, you know, it's probably more of a long term savings than short term savings. And, so, most employers right now with what we see with respect to lower tiers, we see a lot of lower benefit formulas and we also see some changes going from one year final compensation to three year final compensations. We just want you to be aware of so that there are some other benefits that are actually quite expensive that employers might not be thinking about. For example, if you have, if you currently provide some higher COLA's like three, four or five percent, you might want to consider that for lower tier because that could have almost as big as a savings sometime as a benefit formula change. And, also what's called a post retirement survivor allowance benefit. That's also another one that could save, so, that could reduce your cost by at least one to two percent of pay.

So I just wanted you to be aware that the, besides the formula, the one year final compensation, you know, please look at the entire menu of benefits before deciding. There's some other expensive options there that you could consider.

So that pretty much concludes what we've got today.

David Clements:
Okay. Hey, Dave, we've got one question.

Host:
Yes.

David Clements:
From the last part there. Is PERS doing anything to roll back all of the enhanced benefits in order to cut costs?

Host:
What do you mean by? So, rolling back? No, CalPERS is not. Right now as an employer, with respect to your current employees, because of vested rights in California, there's pretty much, not much that can be done. Those benefits have been, you know, it's viewed that the vested right as part of the employment there's nothing you can really do about it. With respect to the new hires, what you've got available to work with right now is the menu of benefit that CalPERS offers. So, for example, for miscellaneous formulas, for miscellaneous

employees, you know, you could go as low as the two at 60 formula. There's even another formula out there for miscellaneous. It's called the 1.5 at 65 formula. It's out there, available. No one ever contracted for it because there's some other limitations like you must provide social security. There's other criteria to it. But, basically right now, again, I think all of these. I know that there's been some talk as part of that pension soundness workgroup to maybe potentially offer like a new benefit formula, like lower than what's caught here in the menu. So I think, right now all I can say is CalPERS is working with the employer labor representative and the legislation to come up some proposals. So, CalPERS is not working alone on this. So we expect some legislative activities over the next year on all of these, on cost sharing, potentially, new lower benefits. So that's pretty much what's happening on this.

David Clement:
Okay. Well.

Host:
Yes.

David Clement:
One last question before we do the survey. Is CalPERS considering canceling ARSC to limit future impacts to employers?

Host:
No. CalPERS is not. Again, ARSC was adding, was basically the benefit that was added to members when a legislation was passed. CalPERS did not sponsor the legislation. CalPERS had no intention of sponsoring legislation to cancel it. Again, if as a group, if as an employer group, if you believe that ARSC should be stopped, I'm assuming through the league of cities or the counties maybe you can sponsor legislation. But CalPERS is, right now has no plan of, has no plans of sponsoring such legislation.

David Clement:
I'm going to ask them.

Host:
Perfect. So, before we end, just, uh, we've got, if you could just, we've got three questions we will like all the users to answer before leaving. So we just want to find out how was your overall experience, and if you had any technical problems? And, also, number three that's really key to us, you know. What is the most important message you will take away from today's webinar?

David Clement:
Yeah. (Indiscernible whisper) [00:58:46].

Host:

Yeah. Well.

David Clement:
(Indiscernible) will put on the web, put on the website.

Host:
Yeah. Yeah. Okay. And, basically, we have a lot of questions that came through, as well. So, again, as I mentioned at the beginning, all of the questions we receive today we're going to put, we're going to come up with a written answer. So, if your question was not specifically asked today, we're just, we're running out of time, we're going to be posting them on our website along with a copy of the power point slide. And, also, as I mentioned, the audio of this presentation would be available, I believe in the form of a video. So you'll be able to see the slide and, basically, what you saw on the screen today and what you heard will be available in the form of a video.

So, perfect. So.

Third party:
You have enough answers?

Host:
Yeah. I believe, huh. Thank you everyone. It looks like most of you had a good overall webinar today. So, we're quite pleased. Again, if you have any other questions, especially specific to your plans, just pick up the phone, call your CalPERS actuaries, they'll be able to, you know, talk to you a bit more in detail as to how all of this relates exactly to your plan. So. So, thank you again everyone for participating. And, we will end right now. Thank you very much.

Mitch:
Thank you. Thank you ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.

End of Audio Transcript

SD:mgf